Split Estates

The relationship between surface and minerals

A Report to the 60th Legislature
October 2006

The House Bill No. 790
Split Estates/Coal Bed Methane
Subcommittee of the
Environmental Quality Council

prepared by Joe Kolman, Research Analyst

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The House Bill No. 790 Split Estates/Coal Bed Methane Subcommittee of the Environmental Quality Council

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Legislative Environmental Policy Office Staff
Todd Everts, Legislative Environmental Analyst
Krista Lee Evans, Resource Policy Analyst
Joe Kolman, Resource Policy Analyst
Maureen Theisen, Publications Coordinator
Cynthia Peterson, HB 790 Subcommittee Secretary

Environmental Quality Council
State Capitol
P.O. Box 201704
Helena, MT 59620-1704
(406) 444-3742

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Introduction

From its first meeting in Havre in August of 2005, the House Bill No. 790 Subcommittee of the Environmental Quality Council embarked on a fact-finding mission about oil and gas development in Montana; specifically the issues surrounding split estates and coal bed methane development.

To fulfill that goal, members hit the road. In addition to Havre, field hearings were held in Sheridan, Wyoming and Sidney. The panel also met six times in Helena. Public comment was heavily solicited—press releases went to all regional newspapers and other media outlets. Issues open to comment at the meetings included reclamation and bonding for oil and gas operations and how to handle split estates, the situation that arises when one party owns surface rights to land and another party owns the mineral rights below the property.

Citizen interest was high. The public provided several hours of comment at each of the field hearings. A total of nearly 80 people testified at those three hearings. Public comment was taken at each of the Helena meetings as well.

The panel members saw first-hand how oil and gas operations are conducted and reclaimed.

Subcommittee members traveled a total of more than 1,600 miles to the three field hearings, which also included tours of conventional gas operations, oil wells, and coal bed methane facilities. Enduring dusty roads in buses and the extremes of Montana weather—the temperature in Havre passed 100 degrees while the thermometer in Sidney read below zero—the panel members saw first-hand how oil and gas operations are conducted and reclaimed.

Included in this report are the Subcommittee's findings in each of the study areas mandated by House Bill No. 790. Also included in some of those areas are recommendations for action. Detailed extensively in the report and the appendices is

the research that the Subcommittee reviewed and considered and more details on the solicitation of public comment and site tours. In regard to the decisionmaking process that the Subcommittee undertook to arrive at its conclusions, the Subcommittee decided that recommendations to the Environmental Quality Council would need to garner at least 8 votes out of the 12 members. While members said that they would strive to reach consensus, they also acknowledged that doing so on all matters related to what could be contentious issues may not be realistic. Brief summaries of votes on issues that earned at least half of the Subcommittee votes but failed to reach the supermajority are included in the Decisionmaking Process section.

Findings & Recommendations

Based on the direction of House Bill No. 790 **(Appendix A)** passed by the 2005 Legislature, the Subcommittee delved into nine areas; conducting research, listening to presentations, and soliciting public comment. Following are the specific subject areas as well as findings and recommendations. Recommended legislation is included in the proposed bill draft located in **Appendix B**. The proposed brochure is in **Appendix C**.

Study the procedures and timelines for giving notice to surface owners.

⇨ **Finding:** Much public testimony centered around what some perceive to be a lack of informed communication between mineral developers and surface owners. Many of those commenting said that communication needs to be improved.

✓ **Recommendation:** The EQC should produce an informational brochure that explains, among other things, the general and legal history of split estates, the process of mineral leasing, and the rights of the surface owner and mineral developer. It should be easy to reproduce, including being downloadable from the Internet. It should serve as an initial source for the owners of minerals and for surface owners to find more information.

✓ **Recommendation:** The brochure should be required by statute to be distributed when notice of seismic exploration activity is given as well as when the mineral developer provides notice of drilling operations to the surface owner.

⇨ **Finding:** Many surface owners said that the current 10-day minimum notice of drilling operations does not provide enough time to plan for the effects of drilling on the property. While industry representatives said that the current notice timeline works well, some noted that they often provide more than 10 days' notice.

⇨ **Finding:** Wyoming and North Dakota require 30 days' and 20 days' notice respectively.

✓ **Recommendation:** Legislation should extend the minimum notice period to 20 days and the maximum notice to 180 days. Legislation also should allow the surface owner to waive the notice requirement.

✓ **Recommendation:** Legislation should clarify that a surveyor may enter the property prior to drilling operations provided that existing law is followed, which includes a 15-day written notice, unless waived or not acknowledged. Legislation should state that the suggested 20-day minimum notice must be provided prior to any activity that disturbs the land surface.

✓ **Recommendation:** Legislation should clarify that there is an existing penalty for violating provisions of the notice requirements.

⇨ **Finding:** Current law requires that "surface users" be notified of seismic exploration operations. But the law says that "surface owners" must be notified of drilling operations. The term "surface user" is not defined in statute and could be construed to mean the owner of the land, the lessee of the land, or both. Since the name of lessees are not typically public record, while the owners are part of the record, in practice it seems that the "surface owner" is typically notified of seismic exploration operations.

⇨ **Finding:** While the surface owner needs to be notified of seismic and drilling operations, there are situations in which an employee or a lessee may be the one most affected by the operations or is the person in charge of daily decisions on the property.

✓ **Recommendation:** Legislation should change the term "surface user" in the seismic notification section of law to "surface owner" to clarify who should be given notice. Legislation also should make it the responsibility of the surface owner to notify any lessees or others who may be affected by seismic or drilling operations of the impending activity.

Study minimum provisions for surface use agreements. Elements that should be considered include road development, onsite water impoundments, and quality and disposal of produced water.

⇨ **Finding:** Industry representatives and some landowners testified that requiring surface use agreements and mandating what should be included in them infringes upon private negotiations between a surface owner and a mineral developer. They also said that such provisions could limit what could be negotiated. Others advocated that

surface use agreements be mandated and put in writing. The Subcommittee was unable to agree that written surface use agreements should be mandated in statute.

✓ **Recommendation:** The EQC should produce an informational brochure that outlines items that may be included or negotiated in a surface use agreement. Additionally, the brochure should be required by statute to be distributed when seismic exploration activity is conducted as well as when the mineral developer provides notice of drilling operations to the surface owner.

Study how to address disagreements on estimated damages.

⇨ **Finding:** Both surface owners and mineral developers said that disagreements over damages do occur, for a variety of reasons. Wyoming has a government mediation program as well as an outside organization where parties may voluntarily participate in mediation of disputes. Some states use forms of arbitration. Both Wyoming and the Bureau of Land Management allow mineral developers to post a surface bond if an agreement on damages cannot be reached. The Subcommittee finds that the efforts of outside organizations that may offer mediation services to surface owners and mineral developers might be beneficial.

✓ **Recommendation:** Legislation should clarify that the surface owner and mineral developer shall attempt to negotiate an agreement on damages.

✓ **Recommendation:** Legislation should clarify that at any point during the negotiations, the surface owner and mineral developer, upon mutual agreement, may enter into dispute resolution processes, including mediation.

***Study bonding requirements based on the type of activity*.**

⇨ **Finding:** From site tours in Havre, Sidney, and the Decker area, it is clear that conventional natural gas, oil, and coal bed methane operations have different effects on the surface. Even different types of oil drilling operations have unique surface impacts.

⇨ **Finding:** Seismic exploration requires a bond that indemnifies the owners of property against physical damages that may arise as the result of seismic exploration.

⇨ **Finding:** The Board of Oil and Gas Conservation requires bonds conditioned for performance of the duty to properly plug each dry or abandoned well.

⇨ **Finding:** In addition to operator bonds, there exist several current funding sources for remediation of sites. Those sources include the oil and gas production damage mitigation account, 82-11-161, MCA; provisions within the reclamation and development grants program, 90-2-1113(2), MCA; and the coal bed methane protection program, 76-15-905, MCA.

✓ **Recommendation:** The Subcommittee has no recommendations.

Assess current reclamation and bonding requirements for coal bed methane operations.

⇨ **Finding:** Coal bed methane wells in Montana fall under the same state reclamation and bonding regulations that cover conventional natural gas wells and oil wells.

✓ **Recommendation:** The Subcommittee has no recommendations.

Evaluate statutes for surface damage, coal bed methane exploration, coal bed methane operations, and coal bed methane reclamation.

⇨ **Finding:** Coal bed methane (CBM) operations in Montana generally fall under the same state regulations that cover conventional natural gas wells and oil wells.

⇨ **Finding:** There exist some statutes specific to coal bed methane operations, including 82-11-175, MCA, which addresses CBM wells that produce ground water and 76-15-905, MCA, which establishes the coal bed methane protection program to compensate private landowners or water right holders for damage caused by CBM development.

✓ **Recommendation:** The Subcommittee has no recommendations.

Explore approaches for balancing mineral rights and surface rights.

⇨ **Finding:** The law governing split estates in this country provides that in order for the mineral right to be recognized as an asset, there must be reasonable access to it. That means that the mineral owner must be allowed onto the surface. But the owner of the surface also has rights and is entitled to damages caused by the extraction of the mineral. The Subcommittee finds that the efforts of outside organizations that may offer mediation services to surface owners and mineral developers might be beneficial.

✓ **Recommendation:** Legislation should clarify that the surface owner and mineral developer shall attempt to negotiate damages.

✓ **Recommendation:** Legislation should note that at any point during the negotiations and upon mutual agreement, the surface owner and mineral developer may enter into dispute resolution processes, including mediation.

✓ **Recommendation:** The EQC should produce an informational brochure that explains, among other things, the general and legal history of split estates, the process of mineral leasing, and the rights of the surface owner and mineral developer. It should be easy to reproduce, including being downloadable from the Internet. It should serve as an initial source of information for the owners of minerals and for surface owners to find more information.

✓ **Recommendation:** The brochure should outline items that may be included or negotiated in a surface use agreement.

✓ **Recommendation:** The brochure should be required by statute to be distributed when notice of seismic exploration activity is given as well as when the mineral developer provides notice of drilling operations to the surface owner.

Identify the relationship between federal law and state law related to split estates.

⇨ **Finding:** In general, when the minerals are owned by the federal government, federal regulations apply. When the minerals in Montana are owned by the state or by private parties, state laws and rules apply.

✓ **Recommendation:** The EQC should produce an informational brochure that explains the difference in regulations between federal and state agencies and provides contacts to find out more information.

Evaluate necessity and feasibility of postoperation reclamation requirements or alternatives, including water pits and impoundments.

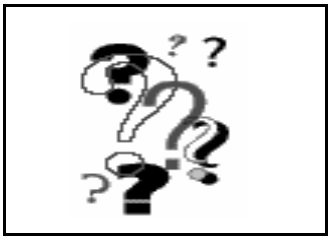
⇨ **Finding:** State law requires the restoration of surface lands to their previous grade and productive capability after a well is plugged or a seismographic shot hole has been utilized and requires necessary measures to prevent adverse hydrological effects from

the well or hole, unless the surface owner agrees with the approval of the Board of Oil and Gas Conservation, in writing, to a different plan of restoration.

⇨ **Finding:** The Montana Board of Oil and Gas Conservation considers water pits and impoundments to be regulated under this statute and the rules that enforce it.

✓ **Recommendation:** The Subcommittee has no recommendations.

The Decisionmaking Process



At its second meeting, the Subcommittee decided that recommendations to the Environmental Quality Council (EQC) would need to garner at least 8 votes out of the 12 members. While members said that they would strive to reach consensus, they also acknowledged that doing so on all matters related to what could be contentious issues may not be realistic.

The Subcommittee instructed staff to prepare a list of regulatory options to serve as a guide for Subcommittee discussion. After discussing the initial option document, the Subcommittee further instructed staff to poll individual Subcommittee members on each of the options. Those results were compiled and reviewed by Senators Wheat and McGee as they prepared the initial bill draft.

The results of the Subcommittee survey are in **Appendix Q**.

The initial bill draft was presented at the March meeting. The Subcommittee went through the draft, section by section, debating each proposed change and new language and voting on proposed changes for each section.

Only proposals winning at least 8 out of 12 votes were deemed to have passed. Those changes were incorporated into another draft for the April meeting. Again, the Subcommittee went through the draft, section by section.

The Subcommittee decided that recommendations to the EQC would need to garner at least 8 votes out of the 12 members.

At its May meeting, the Subcommittee examined the bill draft that incorporated the April changes.

The proposed bill draft contains issues that won at least 8 votes on the Subcommittee. However, the Subcommittee wanted the report to reflect other issues

that won at least half of the votes but failed to reach the supermajority needed for inclusion in the bill draft. Issues and votes are summarized below, by meeting date. Summary minutes as well as audio files of the meetings can be found at: http://leg.mt.gov/css/lepo/2005_2006/subcommittees/hb790

■ January 26, 2006

Revise 82-10-503. Implement a 5-day notice for nonsurface-disturbing activities and a minimum of 20 days' and not more than 180 days' notice for surface-disturbing activities. Parties may waive or otherwise change the notice. **Failed 7-5.**

■ March 16, 2006

Revise 82-1-107. Change term "surface user" to "surface owner". **Failed 6-5.**

In the midst of discussing a proposal that would implement a "bonding on" procedure with a minimum bond of $1,500, a maximum of $10,000, and a blanket bond provision, a motion was made to reduce the minimum bond to $500. **Failed 6-5.**

The Subcommittee passed, with a vote of **8-3,** a provision to implement a "bonding on" procedure with a minimum bond of $1,500, a maximum of $10,000 and a blanket bond provision. However, the "bonding on" provision was rejected at the April 24 meeting by a vote of **8-4.**

■ April 24, 2006

By a vote of **10-1**, the Subcommittee voted to change the term "surface user" to "surface owner" in 82-1-107. A later motion would have changed the language in the draft bill back to "surface user". **Failed 6-6.**

Revise 82-10-503 to require that the notice must include an offer by the oil and gas developer or operator to enter into negotiations with the surface owner to reach an agreement that reasonably accommodates the surface owner's use of the surface while recognizing the dominance of the mineral estate. **Failed 7-5.**

Revise 82-10-504 to provide that the surface owner and oil and gas developer or operator shall attempt to negotiate a "binding written" agreement on damages. **Failed 6-6.**

Revise 82-10-504 to require the oil and gas developer or operator to pay the surface owner a single sum payment for initial damages as well as annual payments over the period of time that the loss occurs, unless otherwise agreed to by the parties. **Failed 7-5.**

■ May 15, 2006

Revise 82-10-504 to include a provision allowing people willing to conduct dispute resolution to contact the Board of Oil and Gas Conservation and be placed on a list that would include their qualifications and fee schedules. The list must be made available to the public. **Failed 6-5.**

Revise 82-10-508 to allow a person seeking compensation for damages to require the oil and gas developer or operator to enter dispute resolution. If there are costs associated with the dispute resolution process, the expense would be split evenly between the two parties. If no agreement is reached, the person seeking damages could file an action in District Court, which may also award attorney fees for failing to comply with this section. **Failed 7-4.**

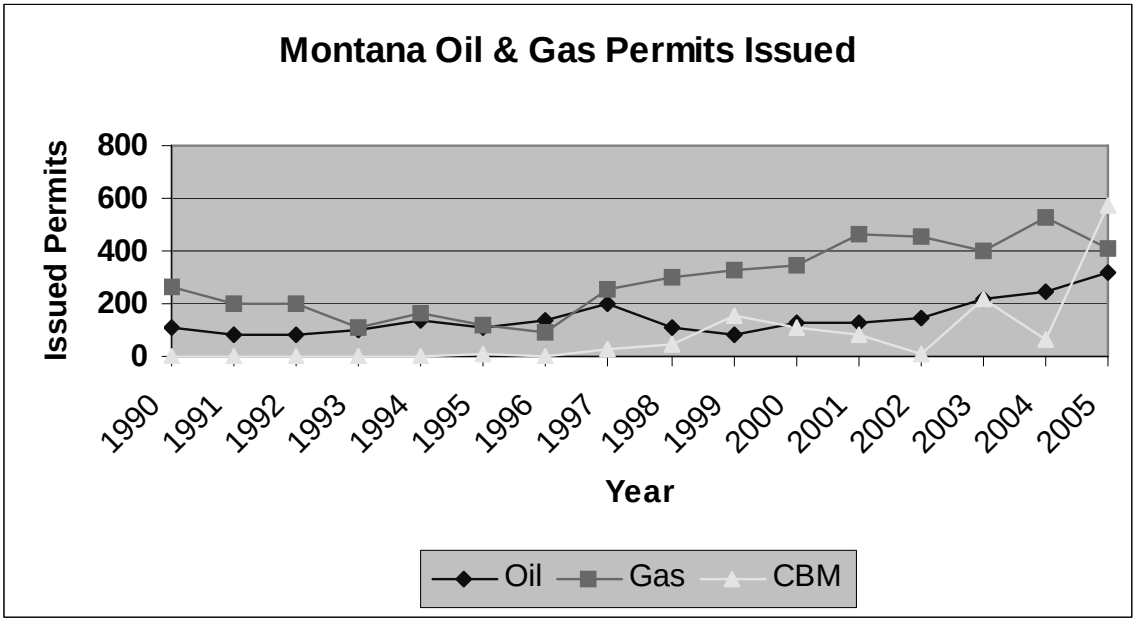
Revise 82-10-508 to provide that if a court awards a person seeking damages an amount that is greater than the highest offer of the oil and gas operator or developer, the person must be awarded reasonable attorney fees. If the amount awarded is equal to or less than the highest offer, the parties pay their own attorney fees and costs. **Failed 6-5.**

Chapter 1: Split Estate and Coal Bed Methane Issues Rise to the Fore

The early 1990s were mostly slow years for oil and gas drilling in Montana. It wasn't until 1997 that the Montana Board of Oil and Gas Conservation issued more than 400 drilling permits in a single year.

But new technologies, increasing demand, and the emergence of coal bed methane gas as an energy source have contributed to a resurgence in mineral development. Drilling for oil, conventional natural gas, and coal bed methane has increased in recent years. In 2005, the Board of Oil and Gas Conservation issued 1,305 drilling permits for those minerals.

The increased drilling activity likely played a role in the heightened awareness of split estate issues in Montana.



A split estate occurs when the right to develop oil or gas deposits has been severed from the surface lands. Therefore, one party will own the land and the right to use it

for such things as building a house or grazing cattle, but another party owns the right to develop the underlying oil or gas deposits. Sometimes, it helps to think of a plot of land as a bundle of sticks, each stick representing a property right. The right to plow or build on the surface is one stick, the right to mine or drill for minerals is another stick.

Prior to colonization of the United States, the English recognized that reserved mineral rights were an asset. The right to future development of those minerals would mean additional revenue. As land was settled in Montana and the rest of the West under numerous Homestead Acts, the government reserved the right to develop coal and other minerals. For more information about the history of split estates in Montana, please see **Appendix D**.

Courts have held that the mineral right has no value unless the oil or gas can be removed from the ground.

Because mineral rights were reserved under the Homestead Acts, the federal government is the largest owner of minerals. In Montana, the federal government owns approximately 26 million acres of surface land and more than 37 million acres of mineral rights. Approximately 11.7 million acres of federal minerals are under private surface land. The Bureau of Land Management manages all the federal minerals and approximately 8 million acres of the federal surface land in the state. The state of Montana, which also leases mineral rights, owns nearly 5 million acres of surface land and mineral rights and about 1.3 million acres of mineral rights only. Private owners may sell the surface to one party and the minerals to another, or the owner of an estate may sell the surface but retain the minerals. Between federal, state, and private ownership of either estate, there could be any combination of ownership. For more information on the distribution of federal split estate lands, please see **Appendix E**. The breakdown of state-owned split estates is contained in **Appendix F**.

Both the surface and mineral owners in a split estate have property rights. But courts have held that the mineral right has no value unless the oil or gas can be removed from the ground. That means mineral owners have the right to reasonable use of the surface, regardless of whether or not the surface owner grants permission. However, state and federal regulations further define this relationship. Many states, including Montana, have laws that regulate how surface owners are compensated for damages

to the land during mineral development. To see a comparison of these laws, please see **Appendix G.**

During the 2005 Legislature, lawmakers considered several measures dealing directly or indirectly with split estates and coal bed methane. Two of the most high-profile were Senate Bill No. 258 and Senate Bill No. 336.

Carried by Senator Mike Wheat of Bozeman, Senate Bill No. 258 would have required the developer to provide notice of upcoming drilling activity to the surface owner 45 days before commencement. Current law requires a 10-day notice. Among other things, the measure also would have required the mineral developer and the surface owner to enter into good faith negotiations to determine the compensation due the surface owner for damages to the land during development. If no agreement could be reached, the developer would have been required to post a bond.

Senate Bill No. 336, proposed by Senator Lane Larson of Billings, would have created a Coal Bed Methane Reclamation Act similar to the mining laws administered by the Department of Environmental Quality. Currently, oil and gas reclamation is under the purview of the Board of Oil and Gas Conservation.

Both measures failed. (The text of both bills can be found on the Web at: www.leg.mt.gov.)

But lawmakers, recognizing that the issues brought forth in the proposals were pertinent to Montanans, did pass House Bill No. 790. The measure was carried in the House by Representative Jim Peterson and in the Senate by Senator Glenn Roush. The law created the Split Estate/Coal Bed Methane Subcommittee of the Environmental Quality Council. The bill provided $50,000 for the Subcommittee to study many of the issues raised in the failed Senate bills.

Chapter 2:
The Interim Process

The Environmental Quality Council (EQC) is a state legislative committee created by the 1971 Montana Environmental Policy Act (MEPA). As outlined in MEPA, the EQC's purpose is to encourage conditions under which people can coexist with nature in "productive harmony". The EQC fulfills this purpose by assisting the Legislature in the development of natural resource and environmental policy, by conducting studies on related issues, and by serving in an advisory capacity to the state's natural resource programs.

The EQC is a bipartisan committee with 17 members: 6 state senators; 6 state representatives; 4 members of the public; and 1 nonvoting member who represents the Governor. The House, Senate, and public members are all chosen by the majority and minority leaders of each house. EQC members are limited to three 2-year terms.

In accordance with House Bill No. 790, the EQC appointed six members from the EQC to serve on the Subcommittee, including Senator Mike Wheat, the chair, Senator Dan McGee, the vice chair, Representative Norma Bixby and Representative Jim Peterson. Public EQC members appointed were Brian Cebull, who works for Nance Petroleum Corporation of Billings, and Doug McRae, a Forsyth-area rancher.

Those members culled through more than 70 applications from people all over Montana as well as other states in filling the remaining six at-large positions. The large number of applications foreshadowed the high interest the issue would generate in the coming months.

The EQC members of the HB 790 Subcommittee recommended, and the co-chairs of the EQC, with concurrence from the vice co-chairs, appointed: Connie Iversen, a landowner in Culbertson; Joe Owen, a Billings landman; Jim Rogers, a Colstrip landowner and supervisor for the Rosebud Conservation District; Lila Taylor, a Busby rancher and former lawmaker; Bruce Williams, a vice president for Fidelity

Exploration and Production Company based in Sheridan, Wyoming; and David Woodgerd of Stevensville, an attorney who formerly worked for the state.

Also appointed to work with the Subcommittee as nonvoting members were Representative Rick Ripley and Senator Glenn Roush.

The enacting legislation contained specific study parameters. The bill specifically requested that the following issues be studied:

1. split estates with regard to ownership of minerals and the ownership of surface property related to oil and gas development;
2. reclamation of surface property affected by coal bed methane development; and
3. bonding requirements for coal bed methane production.

HB 790 also provided that the portion of the study addressing split estates must include:

1. procedures and timelines for giving notice to surface owners;
2. minimum provisions for surface use agreements. Elements that should be considered in surface use agreements are:
   a. road development,
   b. onsite water impoundments; and
   c. the quality and disposal of produced water.
3. provisions for addressing disagreement on estimated damages between the surface owner and the mineral owner; and
4. bonding requirements, if any, based on the type of activity.

HB 790 provided that the portion of the study addressing reclamation and bonding for coal bed methane operations must include:

1. assessing current requirements for reclamation and bonding for coal bed methane operations and determining if they are adequate;
2. evaluating laws related to surface damage, coal bed methane exploration, coal bed methane operations, and coal bed methane reclamation in other states;
3. exploring alternatives and approaches for balancing mineral rights with surface rights;
4. identifying the relationship between federal law and state law with regard to split estates and jurisdiction; and
5. evaluating the necessity and feasibility of postoperation reclamation requirements or alternatives, including water pits and impoundments.

To accomplish these tasks, the Subcommittee adopted a work plan that included research, presentations, and panel discussions.

1. procedures and timelines for giving notice to surface owners
   - X Study index of related research. Staff.
   - X Summary of recent case law regarding split estates. Staff. Aug. 2005
   - X Flowchart of oil/gas permitting. Staff. Aug 2005
   - X Comparison of state surface owner laws. Staff. Sept. 2005
   - X Public testimony and agency panel discussion. Sept. 2005
   - X Outline of surface owner options. Staff. Oct. 2005
   - X Presentation of Wyoming's new split estate law. Oct. 2005
   - X MBOGC presentation on current statute, rules. Dec. 2005

2. minimum provisions for surface use agreements (elements that should be considered include road development, onsite water impoundments, and quality and disposal of produced water)
   - X Study index of related research. Staff.
   - X Comparison of state surface owner laws. Staff. Sept. 2005
   - X Examples of surface use agreements. Staff. Oct. 2005
   - X Outline of surface owner options. Staff. Oct. 2005
   - X Presentation of Wyoming's new split estate law. Oct. 2005
   - X MBOGC presentation on current statute, rules. Dec. 2005

3. address disagreement on estimated damages
   - X Study index of related research. Staff.
   - X Comparison of state surface owner laws. Staff. Sept. 2005
   - X Public testimony and agency panel discussion. Sept. 2005
   - X Outline of surface owner options. Staff. Oct. 2005
   - X Presentation on Wyoming mediation. Oct. 2005
   - X Presentation of Wyoming's new split estate law. Oct. 2005
   - X MBOGC presentation on current statute, rules. Dec. 2005

4. bonding requirements based on the type of activity
   - X Study index of related research. Staff.
   - X Comparison of state surface owner laws. Staff. Sept. 2005
   - X Public testimony and agency panel discussion. Sept. 2005
   - X Outline of surface owner options. Staff. Oct. 2005
   - X Presentation of Wyoming's new split estate law. Oct. 2005
   - X MBOGC presentation on current statute, rules. Dec. 2005

_X_ BLM policy on bonding impoundment ponds. Jan. 2006

_X_ Reclamation and bonding. DEQ, MBOGC, BLM. March 2006

5. assess current reclamation/bonding requirements for coal bed methane operations

_X_ Study index of related research. Staff.

_X_ Flowchart of oil/gas permitting. Staff. Aug 2005

_X_ Comparison of state surface owner laws. Staff. Sept. 2005

_X_ Public testimony and agency panel discussion. Sept. 2005

_X_ MBOGC presentation on current statute, rules. Dec. 2005

_X_ BLM policy on bonding impoundment ponds. Jan. 2006

6. evaluate statutes for surface damage, coal bed methane exploration, coal bed methane operations, and coal bed methane reclamation

_X_ Study index of related research. Staff.

_X_ Comparison of state surface owner laws. Staff. Sept. 2005

_X_ Public testimony and agency panel discussion. Sept. 2005

_X_ MBOGC presentation on current statute, rules. Dec. 2005

_X_ BLM policy on bonding impoundment ponds. Jan. 2006

7. explore approaches for balancing mineral rights and surface rights

_X_ Study index of related research. Staff.

_X_ Summary of recent case law regarding split estates. Staff. Aug. 2005

_X_ Flowchart of oil/gas permitting. Staff. Aug 2005

_X_ Comparison of state surface owner laws. Staff. Sept. 2005

_X_ Public testimony and agency panel discussion. Sept. 2005

_X_ Presentation on Wyoming mediation. Oct. 2005

_X_ Presentation of Wyoming's new split estate law. Oct. 2005

_X_ MBOGC presentation on current statute, rules. Dec. 2005

8. identify relationship between federal law and state law related to split estates

_X_ Study index of related research. Staff.

_X_ Summary of recent case law regarding split estates. Staff. Aug. 2005

_X_ Flowchart of oil/gas permitting. Staff. Aug. 2005

_X_ BLM policy on bonding impoundment ponds. Jan. 2006

_X_ History and current situation regarding new Wyoming law and BLM response. Staff. March 2006

_X_ Report from BLM split estate listening session. Staff. March 2006

9. evaluate necessity and feasibility of postoperation reclamation requirements or alternatives, including water pits and impoundments

- X Study index of related research. Staff.
- X Flowchart of oil/gas permitting. Staff. Aug 2005
- X Comparison of state surface owner laws. Staff. Sept. 2005
- X Public testimony and agency panel discussion. Sept. 2005
- X MBOGC presentation on current statute, rules. Dec. 2005
- X BLM policy on bonding impoundment ponds. Jan. 2006
- X Reclamation and bonding. DEQ, MBOGC, BLM. March 2006

Chapter 3: Public Involvement

From the beginning of the interim, Subcommittee members placed a high value on hearing from those who deal on a daily basis with issues outlined in the study.

The Subcommittee held meetings in Havre, Sheridan, Wyoming, and Sidney. Besides setting aside five days for those three meetings and associated site tours, Subcommittee members traveled more than 1,600 miles to attend the field hearings.

From the beginning of the interim, Subcommittee members placed a high value on hearing from those who deal on a daily basis with issues outlined in the study.

Meetings were slated for those areas because of their proximity to different types of energy development. Conventional natural gas is predominant in the Havre area, while oil is the chief product produced in Sidney. Nearly all of the state's coal bed methane activity is taking place in the area of Montana just north of Sheridan, Wyoming. Another reason for choosing Sheridan was that in 2005, Wyoming passed a split estate law and panel members wanted to hear testimony from those affected by that law.

At each of those three meetings, about 70 people attended. More than 20 people testified at each of the hearings in Havre and Sidney, while 34 stepped up to the podium in Sheridan. The testimony stretched over several hours at each meeting. While attendees were free to talk about any issues related to oil and gas development, the Subcommittee asked for specific testimony on these issues:

* Suggested procedures and timelines, if any, for operators to provide notice to surface owners of impending mineral development;

* Proposed minimum provisions, if any, for surface use agreements, including but not limited to road development, onsite water impoundments, and the disposal of produced water;

* Suggested measures, if any, for addressing disputed damage estimates between operators and surface owners; and

* Proposed bonding requirements, if any.

In addition to much public testimony, the field meetings also garnered significant attention in local newspapers, thus informing an even wider audience about the issues and the work of the Subcommittee. The Subcommittee deliberations were also covered by various media. To read stories written by newspaper reporters who attended the meetings, please see **Appendix H**.

The Subcommittee also held six meetings in Helena, taking public comment at each.

Summary minutes of all meeting of the Subcommittee as well as audio minutes of the Helena meetings are archived at:
www.leg.mt.gov/css/lepo/2005_2006/subcommittees/hb790

Chapter 4: On the Ground - Site Tours

In addition to hearing first-hand the concerns of those who deal with oil and gas development, Subcommittee members determined that it was important to see with their own eyes the way different types of drilling operations that are conducted and reclaimed.

The Subcommittee toured sites around Havre, Sheridan, and Sidney. In each case, the tours were arranged with cooperation between representatives of industry and surface owners. At each of the tours, members of the public joined the tours. Subcommittee members traversed dusty roads in buses; enduring 100-degree temperatures in Havre and below-zero weather in Sidney.

Led by landowner Daryl Sather and representatives of Klabzuba Oil and Gas, the Subcommittee saw several aspects of natural gas production in the Havre area, including compressor stations and a water impoundment pit. The tour was put together by Klabzuba and the Montana Land and Mineral Owners Association.

Photos by Cynthia Peterson

At far left, Subcommittee members and tour participants talk near a natural gas compressor station outside of Havre. At near left, an impoundment pond at the compressor station site.

During the trip to Sheridan, the Subcommittee toured coal bed methane sites around Decker, Montana. The group spent most of the day viewing a reclaimed coal bed methane impoundment pond, a water treatment facility, and a managed irrigation project. Those involved in the tour included Fidelity Exploration & Production Company, Pinnacle Exploration, and the Northern Plains Resource Council.



Photos by Cynthia Peterson

At left, tour participants stand in a reclaimed coal bed methane impoundment pond in Southeastern Montana. At center, is a Northern Wyoming containment pond used to store produced water during the winter. The water will be used for managed irrigation in the summer. At right, a presentation on CBM water treatment is made at a Montana water treatment plant.

Photos courtesy of Nance Petroleum

Around the Sidney area, Subcommittee members saw several aspects of the latest oil activity. The group visited a site similar to that pictured in the photo on the left where a company is recovering oil by hydraulic fracturing, a process where a liquid, usually water, is mixed with sand and pumped down the well at a high pressure. The new fracture, which can extend several hundred feet from the well, connects preexisting fractures and maximizes the flow of oil.

The drilling rig pictured in the photo on the right was at a new site when the group visited. The tour also stopped at reclaimed locations where production facilities had been installed.

Nance Petroleum and the Northeastern Montana Land and Mineral Association coordinated the tour.

Staff also provided the members with maps showing current wells as well as abandoned wells in selected Eastern Montana counties. The maps are included in **Appendix I**.

Chapter 5: Research & Presentations

Research

There are numerous statutes that apply to oil and gas development in the state. Federal regulations also sometimes apply.

Much of the regulation of the oil and gas industry in Montana is the responsibility of the Board of Oil and Gas Conservation (MBOGC), which is attached to the Department of Natural Resources and Conservation. The Board was created in 1953 and renamed in 1971. Its duties are detailed in Title 82, chapter 11, of the MCA. The statutes are implemented in Title 36, chapter 22, of the Administrative Rules of Montana.

The seven-member Board, which is appointed by the Governor, must consist of three representatives of the oil and gas industry with at least 3 years of experience in the production of oil and gas and two members who are landowners who reside in oil or gas producing counties of the state but who are not actively associated with the oil and gas industry. One of the landowners must own the mineral rights with the surface and the other must be a landowner who does not own the mineral rights. One member must be an attorney licensed to practice in Montana.

The Board's duties include issuing drilling permits; establishing well spacing units and land pooling orders; inspecting drilling, production, and seismic operations; investigating complaints; conducting engineering studies; and collecting and maintaining well data and production information. The Board also administers the federal Underground Injection Control Program for Class II injection or disposal wells under the Safe Drinking Water Act.

The Board oversees most operations on state and private lands that may have state or private minerals underneath. In areas where the federal government owns and leases the minerals, the U.S. Bureau of Land Management (BLM) is the lead agency.

Since 1987, the MBOGC and the BLM have been coordinating their decisions on drilling permits. Under an agreement, the MBOGC accepts BLM approval of drilling permits for federal minerals in Montana.

The Montana Department of Environmental Quality (DEQ) also plays a role in the regulation of oil and gas operations. The agency implements laws related to water and air quality as well as management of waste.

Since the DEQ is delegated the responsibility for administering some federal environmental laws, such as the Clean Water Act and the Clean Air Act, the agency is involved in operations where the federal minerals are leased.

Attached to the DEQ is the Board of Environmental Review. The Board consists of seven members appointed by the Governor. The members must be representative of the geographic areas of the state. One member must have expertise or background in hydrology. One member must have expertise or background in local government planning. One member must have expertise or background in one of the environmental sciences. One member must have expertise or background as a county health officer or as a medical doctor. One member must be an attorney licensed to practice in Montana.

The Board of Environmental Review adopts rules and standards for how the DEQ carries out the intent of the law. For example, state statute gives the Board the authority to adopt rules “governing application for permits to discharge sewage, industrial wastes, or other wastes into state waters, including rules requiring the filing of plans and specifications relating to the construction, modification, or operation of disposal systems”.

On Tribal lands, the Bureau of Indian Affairs and the Environmental Protection Agency assume some of the duties of the BLM and the DEQ, respectively.

To illustrate the various laws and regulations that apply to oil and gas operations, staff prepared two flowcharts. One shows the state permitting process; the other shows the federal permitting process. The charts are contained in **Appendix J**.

The Subcommittee largely focused on Montana’s surface owner damage and disruption compensation statutes, Title 82, chapter 10, part 5, MCA. As part of the

evaluation of those laws, the Subcommittee reviewed similar laws in other states. Please refer to **Appendix G** for key parts of those laws.

Presentations

Many of the Subcommittee meetings included presentations scheduled by the Subcommittee as well as impromptu presentations during the extensive public comment periods. Following are brief summaries of those presentations solicited by the Subcommittee. Many presenters also answered multiple questions from the Subcommittee. Those responses, summaries of all presentations, as well as audio recordings for those made in Helena are available on the Subcommittee's website: www.leg.mt.gov/css/lepo/2005_2006/subcommittees/hb790

■ September 15, 2005 (Helena)

Jeanie Alderson, an eastern Montana rancher and member of Northern Plains Resource Council, said that the 10-day notice requirement is too short and should be modified to 1 year. She also said that landowners should be included in all leasing decisions before development occurs, landowners should be notified when their minerals are leased, and arbitration should be utilized in the event that damages are incurred by the landowner. Ms. Alderson suggested that a bond be implemented to protect surface owners in the event that a company disappears and leaves the landowner with substantial damages.

Wayne Ransbottom, Land Manager for Fidelity Exploration and Production Company of Sheridan, Wyoming, said that Fidelity tries to begin negotiations at least 8 months in advance of any proposed development. He explained the negotiation procedure used by Fidelity to identify and address landowners' special needs prior to development. Mr. Ransbottom explained the need for repeated access to land prior to submitting a development plan. When a plan of development is submitted to the BLM prior to development, he said that is another opportunity for the surface owner to interject with objections or concerns. He added that careful planning with the surface owner can minimize surface impacts.

Senator Keith Bales, a surface and mineral owner, said that surface use agreements have changed over the years, which makes him skeptical about putting into law what should be included in a surface use agreement. Senator Bales said that if a surface

use agreement listed what damages landowners could be paid for, landowners would be severely limited. He said that the Subcommittee should not recommend a law that would limit his potential as a landowner. Senator Bales believed that a 30-day notification period would be ample, but he was uncertain about the need to extend the notification period. He said that bonding should be used only as a last resort and identified other sources of funding that could be used for reclamation of coal bed methane operations. He said that laws passed in Montana in the 1970s resulted in a coal boom for Wyoming. He believes Montana should be developing its natural resources.

Ray Muggli, a land and mineral owner in southeastern Montana and a member of the Northern Plains Resource Council, said that he is concerned about the magnitude of coal bed methane development and the resulting damage to the surface, especially containment ponds and the sodium content of the water. He said that Montana should find a better way to manage the water and soil in the Tongue River Valley. He said that the 10-day notice requirement is inadequate.

Will Lambert of the Bureau of Land Management provided background information on BLM duties. He said that in most cases, agreements between landowners and oil and gas companies are reached and his experience indicates that there have been very few conflicts between landowners and oil and gas producers. He said that the BLM's notification period is, at a minimum, 30 days due to the BLM's posting requirements. Mr. Lambert said that the BLM includes the landowner in its decisions. In addition, BLM requires bonding to cover noncompliance, plugging of wells, nonpayment of royalties, and reclamation. The bonding has a minimum amount of $1,000, and the amount is determined by the level of risk. Mr. Lambert referred to a U.S. Department of Interior memorandum that sets forth BLM's process. This can be found in **Appendix K**.

Monte Mason, the Minerals Management Bureau Chief, Montana Department of Natural Resources and Conservation (DNRC), gave an overview of DNRC's process of leasing minerals. Mr. Mason said that surface owners are able to bid on leases in the public process and successful landowners are obligated to diligently develop the minerals. DNRC does not hold separate bonding on its leases. Mr. Mason said that landowners are entitled to compensation for damages and that the lessee must repair, replace, or compensate for any damages. In addition, lessees must provide confirmation that they have met with the surface owner and have reached an

agreement. If the lessee has made a good faith effort to reach an agreement with the surface owner, the DNRC may authorize the lessee to proceed. He said that arbitration is also an element of state land leases. More information about how DNRC handles mineral leases is contained in **Appendix L**.

Greg Petesch, Chief Legislative Attorney, addressed the "accommodation doctrine" and Model Surface Use and Mineral Development Accommodation Act. Mr. Petesch provided a history of the drafting committee that wrote the Act, which codifies the accommodation doctrine that was developed through common law and case law. Mr. Petesch said that the right to develop the mineral estate overrides the surface estate, carries with it implied easements of access, and requires the mineral plan to accommodate surface uses. Whenever state land is sold, the state is required to reserve the mineral rights; therefore, a split estate is created whenever the state sells land. The text and an explanation of the Act are contained in **Appendix M**.

■ September 16, 2005 (EQC meeting)

Jim Halvorson, Petroleum Geologist, Montana Board of Oil and Gas Conservation (MBOGC), reviewed well permitting requirements and processes, including what is required when submitting a permit and the analysis to which a permit application is subjected. An outline of the process is contained in **Appendix N**.

Will Lambert of the Bureau of Land Management (BLM) explained the BLM's permitting process and bonding. The operator submits a complete Application for Permit to Drill (APD) that includes evidence of bond, a survey plat, a drilling plan, a surface use plan, interim reclamation and final reclamation plans, and a water management plan. For split estates, the operator is required to submit certification that an agreement has been reached with the landowner. APDs are posted for a minimum of 30 days. The BLM is required to comply with the National Environmental Policy Act. For coal bed methane development, the BLM works with the MBOGC and DEQ to do a joint environmental analysis. The environmental analysis results in conditions of approval for a permit to drill, which become attached to the APD and are subject to enforcement. He said that his agency's goal is to issue APDs within 35 days, although the coal bed methane process takes at least 4 months. The BLM utilizes lease bonds for $10,000, statewide bonds for $50,000, and nationwide bonds for $150,000, and BLM has authority to raise bond amounts if it determines that an operator is an at-risk operator. BLM has not experienced any defaults on bonds in

Montana in the past 6 years. For split estates, the BLM requires operators to enter into good faith negotiations with landowners and, in the majority of cases, this is achieved. If an agreement cannot be reached with the landowner, the operator is required to post a minimum $1,000 bond, which will be used for damages to crops and tangible improvements. The landowner has the right to protest the bond amount set by BLM.

Tom Reid, Supervisor of Water Quality Permitting, Montana Department of Environmental Quality, discussed regulation of pollutants discharged to state waters.

Jack Stults, Division Administrator, Water Management, Montana Department of Natural Resources and Conservation, addressed coal bed methane (CBM) development and how it affects water rights. He said that CBM discharge is a byproduct and not a beneficial use of water. He said that in the Powder River Basin Controlled Groundwater Area, the water byproduct of CBM does not inherently create or require a water right. The Controlled Groundwater Area requires all producers to offer a mitigation agreement to every water right within 1 mile of any CBM well. This shifts the burden of proof to the producer if a well is impacted. If a well is impacted, the 1-mile requirement expands out from the impacted well.

■ October 27, 2005 (Sheridan, Wyoming)

Representative Rosie Berger of Big Horn, Wyoming, explained how she pursued legislation to address split estates. She said that producers are now doing more planning since the new legislation acts as a hammer and requires that surface owners be included in planning. But she added that the law may need to be tweaked. Representative Berger identified competition among developers as an unintended consequence of the legislation. Mediation is included as part of the surface use agreement, which is a private contract between the landowner and the developer. She said that it is too early to know whether the legislation was effective.

Laurie Goodman of the Landowners Association of Wyoming said that her organization was formed to pass Wyoming's legislation and to focus on the legal aspects of the legislation. She said that the legislation contained a 30-day notice requirement, but it had been suggested that landowners need a minimum of 6-months' notice. Ms. Goodman said that well spacing should be required to be disclosed since well spacing directly impacts the land. She advised the Subcommittee

to avoid mandating what the surface use agreement should look like and to leave those decisions up to the landowner. Ms. Goodman emphasized the importance of "lost land value" language and explained how landowners can be impacted for more acreage, depending upon the land use. Loss should include commercial, agricultural, and lost land values. Wyoming's legislation did not contain any damage appraisal language. She discouraged lengthy bonding provisions and said that waivers are important in cases where landowners are satisfied with their current situation. She said that she would have liked to strengthen the provisions for water management and water protection.

Lucy Hanson, the coordinator for the Wyoming Agriculture and Natural Resource Mediation Program, explained the state's mediation program and how it relates to the Wyoming Split Estate Initiative. She suggested that the Subcommittee would need to consider which entity would take the initial request for mediation and act as the coordinator.

■ December 9, 2005 (Sidney)

Dennis Guenther of Nance Petroleum said that the company provides notice at least 10 days before staking a well and, if asked by the surface owner, will contact any lessee. The 10-day notice gives the operator flexibility, he said, in the case of rigs becoming available on short notice, spring rains preventing access to a location, or an unexpected dry hole. Having a rig on standby is expensive, he added. In regards to bonding, he said that the state bond is already in place, the operator is liable for any damages not included in the agreement, and the agreement covers damages. In more than 25 years of business, he said that he has always reached agreements with surface owners.

Dennis Trudell of the Northeastern Montana Land & Mineral Association said that the current law needs "teeth" and a longer notification period. He said that annual rental fees would protect the landowner and provide fair compensation for the inconvenience, disruption, and damages that the landowner experiences. Landowners do not pursue the annual rental amount now since it would necessitate hiring an attorney.

Tom Richmond, Administrator of the Montana Board of Oil and Gas Conservation, explained some aspects of current law in Montana and other states and suggested

how changes might be made if the Subcommittee chooses to support legislation. Mr. Richmond did not advocate changes, but his comments included:

• Current law says notice of drilling operations must be given to the surface owner at least 10 days and not more than 90 days before commencement. Mr. Richmond said that it could be changed to 20 days and 180 days.

• Providing notice to surface owners when minerals are leased could prove difficult, Mr. Richmond said, because a single tract could have more than 30 mineral owners.

• Mr. Richmond said that Montana law, which now implies that there must be a surface damage agreement, could be made clearer. He said that the question of state involvement in a private agreement is a difficult one, but added that some key elements to be included in agreements could be outlined in statute.

• Wyoming mandates a $2,000 surface bond if the landowner and the mineral developer cannot reach a damage agreement. Mr. Richmond said that such a requirement could be contested in court. But he added that if Montana adopts that kind of law, it should be very specific about who would hold the bond. On other bonding issues, Mr. Richmond said that the Subcommittee should consider the comprehensiveness of current rules, adding that there have been very few orphaned wells—those abandoned by the developer—since 1980.

• Laws in Montana, Wyoming, and North Dakota generally do not separate coal bed methane development from traditional oil and gas regulations, Mr. Richmond said, adding that doing so could make regulation more difficult.

More information on current split estate laws, the regulation of coal bed methane development, active wells, and orphaned wells is contained in **Appendix O**.

■ January 26, 2006 (Helena)

Dave Galt of the Montana Petroleum Association (MPA) said that oil and gas operations in Montana vary in size and in other aspects. He said that the current law has been reviewed and serves both surface owners and the industry well. Mr. Galt said that the MPA is working with the Farm Bureau and others on an informational document to assist surface owners in working with oil and gas operators.

Bob Fisher of Ballard Petroleum Holdings in Billings said that the current notification period works and is fair. Generally, he said, surface owners are contacted a considerable time before drilling operations. Extending the notification period, he

said, would allow those who do not want the development on their land to use the notification to delay the process.

Mark Carter of Encore Acquisition Company said that drilling schedules can change based on drilling results. He added that surface agreements set minimum standards. Mr. Carter said that the mineral owner has the right and needs the ability to develop minerals without unnecessary delays. Changing the law would deter drilling in Montana, he said, thereby lowering tax revenues, decreasing the number of high paying jobs, and creating undue litigation.

Todd Ennenga of Devon Energy Corporation said that mandating surface agreements and the language in them would erode good will between surface owners and mineral developers. He said that the 10-day notice is adequate, especially considering such things as changes in weather and the availability of drilling rigs. He said that a waiver should be included so the operator can enter property for certain emergencies. Mr. Ennenga also said that a brochure should be created that spells out the rights of both parties and can be widely distributed.

Colby Branch, a natural resource attorney with the Crowley Law Firm in Billings, said that the Subcommittee should not recommend any changes to the current statute. He said that legislation that reallocates the rights of the surface owners and the mineral owners would rewrite thousands of deeds and oil and gas leases. He said that the Supreme Court determined statutes must serve a public, not private, interest, and the state should not get involved in a private contract between two parties. Mr. Branch said that the 10-day notice is sufficient, the current law provides adequate compensation for damages, and the courts can be used to resolve damage disputes. He said that legislation would not affect federally reserved minerals managed by the BLM since they are governed by federal law.

Patrick Montalban of Altamont Oil and Gas referred to a letter he sent to the Subcommittee that suggested the 10-day notice could be changed to 15 days and recommended that a committee be established under the Montana Board of Oil and Gas Conservation that can adjudicate disputes between the surface owner and mineral developer.

■ March 16, 2006 (Helena)

Tom Richmond of the Montana Board of Oil and Gas Conservation discussed current bonding laws and rules. Mr. Richmond made the distinction between reclamation bonds and the use of those bonds to restore the surface, and "bonding on", which is used to pay the landowner for damages.

Jim Albano, the lead minerals specialist for the Bureau of Land Management (BLM) in Billings said that an oil and gas lessee or operator must have a bond before disturbing the surface for drilling operations. The BLM can increase the amount of the bond if it is determined that the operator has an increased level of risk. The bond can be also be increased if 5 years previous to a drilling proposal, a demand was made on a bond for plugging and reclaiming land. In reference to split estates, Mr. Albano said that a good faith effort needs to be undertaken by the mineral lessee to either negotiate a surface agreement or obtain a waiver from the surface owner. Mr. Albano explained that "bonding on" is required if no agreement between the surface owner and operator is reached. The purpose of the bond is to ensure compensatory protection for the surface owner. Mr. Albano said that the BLM didn't use "bonding on" until 2004. He added there is always a possibility that an agreement can be reached any time in the process, which would necessitate termination of the bond. A flowchart of the "bonding on" process, documents explaining bonding for CBM impoundment ponds in Wyoming, and a BLM-produced brochure on mineral development in split estate situations are contained in **Appendix P**.

Steve Welch of the Department of Environmental Quality provided an overview of how the agency bonds for various mining activities as well as solid and hazardous waste management. What the bonding for all areas has in common, he said, is that the bond must be sufficient for a third party to perform work to specific standards. He discussed coal and uranium prospecting bonding and the U.S. Department of the Interior Office of Surface Mining's Handbook for Calculation of Reclamation Bond Amounts.